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IN THE

# Supreme Court of the United States

OCTOBER TERM, A. D. 1936.

No. [redacted] 30

UNITED STATES OF AMERICA, on relation of Chester A Willoughby, as Trustee in Bankruptcy of National Mechanical Service Company, a corporation, et al.,

*Petitioners,*

vs.

SAM HOWARD and CONTINENTAL CASUALTY COMPANY, a corporation,

*Respondents.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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**No. _____**

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UNITED STATES OF AMERICA, on relation of Chester A Willoughby, as Trustee in Bankruptcy of National Mechanical Service Company, a corporation, et al.,

*Petitioners,*

vs.

SAM HOWARD and CONTINENTAL CASUALTY COMPANY, a corporation,

*Respondents.*

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**PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.**

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*To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:*

Your petitioner, Chester A. Willoughby, as Trustee in Bankruptcy of National Mechanical Service Company, a corporation, *et al.*, respectfully prays that a writ of certiorari issue to the Circuit Court of Appeals for the Sev-

enth Circuit to review a decree of that Court entered January 8, 1937, reversing a decree of the United States District Court for the Northern District of Illinois, Eastern Division (rehearing denied January 29, 1937). A certified transcript of the record in this case, including the proceedings in said Circuit Court of Appeals, is furnished herewith, in accordance with Rule 38, Paragraph 1, of the Rules of this Court.

## STATEMENT OF MATTERS INVOLVED.

Because the above-entitled cause involves the question of liability of a trustee and his surety on official bonds filed in 114 separate bankrupt estates and of liability of a receiver and his surety on official bonds filed in 9 other separate bankrupt estates, a somewhat extended statement is necessary in order clearly to set forth the matters involved.

Three suits at law were brought in the United States District Court for the Northern District of Illinois, Eastern Division, in the name of United States of America on the relation of Chester A. Willoughby, acting in his official capacity as Trustee in Bankruptcy of certain bankrupt estates against Sam Howard, one of the respondents herein, upon his official bonds as Trustee in Bankruptcy in 114 separate bankrupt estates and as Receiver in Bankruptcy in 9 separate bankrupt estates, and against Continental Casualty Company, a corporation, the other respondent herein, as surety upon all of said official bonds.

During the month of May, 1934, Howard resigned as Trustee or Receiver in all of said estates and was succeeded by Chester A. Willoughby who, as such Trustee and Receiver, is the petitioner herein. All of said bankrupt estates were subject to the jurisdiction of the United States District Court for the Northern District of Illinois, Eastern

Division. These three suits involve all 123 of said estates, and, by agreement of all the parties, were consolidated for trial and tried by said District Court. (Tr. 51.)

Prior to August 25, 1930, Howard as trustee and receiver kept funds of his bankrupt estates on deposit in the Central Trust Company of Illinois and the Foreman-State National Bank, both of which were banking corporations located in Chicago, Illinois. (Tr. 169, 256-258.) He had personal unsecured loans of $2,500.00 at the Central Trust Company and of $7,000.00 at the Foreman Bank. (Tr. 258.)

Shortly prior to July 15, 1930, one Beutel, a vice-president of the Central Trust Company, advised Howard that he anticipated becoming president of the Phillip State Bank and Trust Company of Chicago (hereinafter called the "Phillip Bank") and invited said Howard to change his estate deposits from the aforesaid banks to the Phillip Bank (Tr. 164, 256), although at that time the Phillip Bank was not a depository qualified to accept the funds of bankrupt estates. (Tr. 143.) Howard replied that he was not a man of any means and if he transferred his estate deposits to the Phillip Bank he would wish to obtain an unsecured loan from that bank to liquidate his other loans above mentioned. (Tr. 257.) Said Beutel told Howard that the Phillip Bank would make him a loan so that he could liquidate said loans with the Central Trust Company and the Foreman Bank (Tr. 165, 257) and also would loan him such further sums as said Howard required to conduct his business.

As a result of said arrangement between Howard and said Beutel, the Phillip Bank loaned $5,000.00 to Howard on his unsecured note on August 6, 1930, and loaned him the further sum of $6,000.00 on August 19, 1930. (Tr. 77, 79, 258.)

Thereafter, on August 20, 1930, the Phillip Bank filed a bankruptcy depository bond for $50,000.00 (Tr. 113) and qualified to act as such depository. Between August 25, and August 31, 1930, Howard deposited in the Phillip Bank, in his capacity as receiver or trustee of said estates, the sum of $249,968.15. (Tr. 73.)

The last published statement of the financial condition of the Phillip Bank prior to the making of said deposits, was as of June 30, 1930, and showed liabilities of $4,367,897.93, of which $1,610,294.96 were demand deposits, and $1,858,-076.90 were time deposits. (Tr. 84.)

Commencing with the initial deposits of $249,968.15, the deposits in the Phillip Bank of Howard as trustee or receiver increased until at the time said bank failed on June 21, 1932, said deposits amounted to $416,833.90, the largest deposits Howard had in said bank at any time. (Tr. 72.)

The original personal unsecured loans of $11,000.00 made to Howard in August, 1930, increased to $18,515.00 on July 11, 1931, and amounted to $17,500.00 on June 21, 1932, the date said bank failed. (Tr. 77, 78.)

During the period that Howard was increasing his deposits as trustee and receiver in the Phillip Bank, said bank underwent five serious runs. A run in April, 1931 (Tr. 169) required the borrowing of $1,000,000.00. Another run occurred in June, 1931. (Tr. 171, 176.) A run in September, 1931 (Tr. 176; 177) required the borrowing of about $500,000.00; and a run in December of 1931, cost the bank $500,000.00. (Tr. 177.) The fifth run resulted in the failure of the bank on June 21, 1932. (Tr. 178.)

Howard had knowledge of each of these runs (Tr. 169, 171, 173, 176, 177, 192, 193) and discussed them with officers of the bank (Tr. 259-263), and, in addition, was charged with knowledge of the publications required by the Auditor

of Public Accounts of the State of Illinois of the condition of the bank (Tr. 271), said publications showing the condition of said bank as of the following dates: June 30, 1930 (Tr. 84); September 24, 1930 (Tr. 86); December 31, 1930 (Tr. 89); March 25, 1931 (Tr. 91); June 30, 1931 (Tr. 93); September 29, 1931 (Tr. 96); December 31, 1931 (Tr. 98); and March 30, 1932 (Tr. 100). Said statements in each instance were published shortly after the date as of which they were made. Howard indicated that he looked at the quarterly reports and then threw them away. (Tr. 271.)

While Howard was increasing the amount of estate moneys deposited in said bank and increasing his personal borrowings therefrom, its demand and time deposits as a whole were decreasing. On March 25, 1931, demand deposits were $2,481,918.79 and time deposits were $1,329,-720.39. (Tr. 92.) On December 31, 1931, demand deposits had decreased to $1,938,427.13, of which $252,461.18 were deposits of said Howard's estates, and time deposits had decreased to $655,357.11. (Tr. 72, 98.) At the time said bank closed the total deposits, both demand and time, were $2,101,710.51, of which $416,833.90 were deposits of Howard's estates. (Tr. 72.)

The moneys of 123 bankrupt estates here involved are a portion but not all of the estate moneys which Howard had on deposit with the Phillip Bank. (Tr. 72.)

After the failure of the Phillip Bank, its $50,000.00 depository bond was collected and paid in reduction of the loss to the bankrupt estates whose money was on deposit in said bank, which resulted in a distributive dividend to each of said estates of 11.0461% of the estate money on deposit. (Tr. 13-28, 61, 67.) The amount for which suit was brought in these cases was the amount on deposit in each of the estates here involved at the time the Phillip Bank failed, less the amount of such distributive dividend,

except in the case of estates in which the amount of the trustee's or receiver's bond was less than the amount on deposit after crediting the above-mentioned distributive dividend, in which case the amount sued for was the full amount of the bond. (Tr. 61-64, 67.) The amount sought to be recovered was $5,439.22 on the Trustee's bond in one suit (Tr. 61), $197,076.31 on 113 Trustee's bonds in another suit (Tr. 64), and $23,224.92 on 9 Receiver's bonds in a third suit (Tr. 67), an aggregate of $225,740.45.

The conditions of the official bonds of Howard as trustee or receiver were in substance that he and his surety were to be liable for losses resulting to said estates upon:

(a) Failure of Howard to obey any order of the Court.

(b) Failure of Howard faithfully and truly to account for all of the moneys, assets or effects of the estates.

(c) Failure of Howard in all respects faithfully to perform all of his official duties as trustee or receiver. (Tr. 59, 65.)

The complaint set forth in separate counts the deposit of each estate in the Phillip Bank and other factual data sufficient to establish the amount of the loss suffered by each estate as a result of the closing of said bank and the portion of such loss covered by Howard's official bonds. Said complaint also set forth the relationship of Howard to the Phillip Bank, the history of the runs thereon and the fact that Howard knew of the condition of said bank, and alleged that he negligently and carelessly permitted the moneys of said estates to remain on deposit in said bank, that he did not faithfully and fully account for the moneys of the estates, did not faithfully perform his duties as trustee or receiver, did not report in writing the condi-

tion of the estates, and that he did not exercise reasonable care, prudence and caution in his official capacity.

The jury rendered verdicts for the plaintiffs in each of said three cases, in the aggregate amount of $225,740.45 (Tr. 52, 383), the full amount claimed, and judgment was entered for the plaintiff in the full amount of said verdicts. (Tr. 56.)

The defendants appealed to the United States Circuit Court of Appeals for the Seventh Circuit, said appeal being argued before the Court on May 19, 1936, Judges Evans and Lindley sitting. (Tr. 391.)

Thereafter, said Court ordered a re-argument of said appeal, which was heard on November 18, 1936, by Circuit Judge Evans and District Judges Lindley and Briggle. (Tr. 392.) On January 8, 1937, Circuit Judge Evans filing a dissenting opinion, (Tr. 402), the Circuit Court of Appeals reversed the judgment of the District Court and remanded the case for a new trial, in accordance with directions contained in said opinion, said directions in substance being to direct a verdict for the respondents and not to submit to the jury the question of whether Howard was negligent in making deposits in a designated depository. (Tr. 393.) The plaintiffs thereupon petitioned the Court for a rehearing which was denied on January 29, 1937. (Tr. 406.)

## REASONS FOR GRANTING THE WRIT.

I.

The Court below has decided an important question of general law in a way probably untenable or in conflict with the weight of authority by holding that, so long as he keeps the moneys of his estates in a designated depository, a trustee or receiver in bankruptcy may treat such moneys in reckless and knowing disregard of their safety, and may jeopardize them to obtain personal financial accommodations, without making himself or his surety liable upon his official bond for loss resulting therefrom.

II.

The Court below has decided an important question of Federal law which has not, but should be settled by this Court, the importance and the unsettled state thereof apparently having been recognized in part by this Court by its recent adoption of General Order in Bankruptcy LIII.

III.

The Court below has decided a Federal question in a way probably in conflict with applicable decisions of this Court, apparently as a result of confusing the obligations of a trustee or receiver in bankruptcy in respect of estate moneys, which are private funds, with the obligations of a public officer in respect of public funds.

WHEREFORE, your petitioners pray that a writ of certiorari be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals for the Seventh Judicial Circuit, sitting at Chicago, Illinois, commanding said Court to send to this Court on a day to be designated, a full and complete transcript of the record and all proceedings of the Circuit Court of Appeals had in this cause, to the end that this cause may be reviewed and determined by this Court; that the orders of the Circuit Court of Appeals for the Seventh Judicial Circuit reversing said decree of the District Court be reversed and remanded; and that the petitioners be granted such other and further relief as may seem proper.

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# BRIEF IN SUPPORT OF PETITION.

## I.

### Opinions Below.

The judgments of the District Court appear in the record. (Tr. 56, 384.) No opinion was rendered by said Court.

The opinion of the Circuit Court of Appeals is reported in 87 F. (2d) 243. (Tr. 393.)

## II.

### Jurisdiction.

The jurisdiction of this Court is invoked under Section 240-(a) of the Judicial Code as amended by the Act of February 13, 1925. (28 U. S. C. A., Sec. 347-(a).)

The date of the decree of the Circuit Court of Appeals for the Seventh Circuit (Tr. 393) sought to be reviewed was January 8, 1937, and a rehearing was denied on January 29, 1937. (Tr. 406.)

## III.

### Statement of the Case.

The facts have been fully set forth under the caption "Statement of Matters Involved" which is hereby adopted.

## IV.

### Specifications of Error.

The Circuit Court of Appeals erred:

(a) In reversing the judgment of the District Court.

(b) In holding that loss resulting from the negligence of a trustee or receiver in bankruptcy in depositing or maintaining deposits of his estate moneys is not chargeable to his bondsman.

(c) In holding that the loss of estate moneys because of acceptance of personal favors by a trustee or receiver in bankruptcy in consideration of depositing and maintaining bankrupt funds in one depository, is not chargeable to his bondsman.

(d) In holding that a surety on a bond of a trustee or receiver in bankruptcy could not be charged for the loss of bankruptcy funds because of negligence in depositing and maintaining excessive amounts belonging to numerous estates in one designated depository when there was a choice available among a number of such depositories.

(e) In holding that under the provisions of the Bankruptcy Act, the bondsman could constitutionally be relieved by the Bankruptcy Act for negligence, resulting in the loss of bankruptcy funds, committed by a trustee or receiver in bankruptcy in depositing and maintaining of bankruptcy (private) funds in a designated depository.

## SUMMARY OF ARGUMENT.

### I.

**The Circuit Court erred in setting aside the judgment in the District Court, based upon the verdict of the jury.**

### II.

**A failure to exercise ordinary care in the performance of a statutory duty is a breach of a bond requiring that an official shall in all respects faithfully perform all his official duties as a trustee and the duties of his trust.**

### III.

**The jury, under suitable instructions, found that Howard had breached his official bonds.**

### IV.

**The public fund depository system (31 U. S. C. A. Sec. 476) and the plan provided in Section 47 of the Bankruptcy Act (11 U. S. C. A. Sec. 75) and Section 61 of the Bankruptcy Act (11 U. S. C. A. Sec. 101) have no relation to each other.**

V.

No precedents can be obtained from the decisions, as to the liabilities of sureties upon official bonds for public funds under State statutes, which are of any benefit in the general consideration of the rules regarding liability for the loss of bankruptcy deposits in bankruptcy depositories.

VI.

Neither the Congress of the United States nor the State Legislatures can constitutionally relieve public officials or quasi-public officials of the United States or the States from the result of their negligence.

VII.

Howard violated each of the bonds that he gave as trustee and receiver, and his surety is liable for loss resulting from each of such violations.

## ARGUMENT.

### I.

**The Circuit Court erred in setting aside the judgment in the District Court, based upon the verdict of the jury.**

The majority of the Circuit Court of Appeals summed up its opinion as follows:

> "Howard's knowledge of the condition of the bank and his personal loans there, are to our mind facts immaterial in an action upon these bonds. They constitute no breach of the conditions. What their legal effect may be in an action against the Trustee personally, we are not called upon the to decide." (Tr. 402.)

The implication of the foregoing is that in selecting a depository and placing and maintaining bankruptcy funds therein, a trustee or receiver in bankruptcy may be guilty of a lack of every care or precaution which a reasonably cautious man would exercise in the care of his own funds, that he may ignore apparent dangers to the funds caused by the financial condition of the depository, runs thereon, loss of capital, bad management, or even the failing condition thereof. He may place bankruptcy funds therein because of personal favors or cause various depositories to bid for such funds by the promise of fees, favors, or for corrupt motives. He may, without regard to the strength of the depository, deposit therein bankruptcy funds many times the amount of the depository bond. Yet, if bankruptcy funds are lost by reason thereof, he cannot be guilty of actionable negligence in such a manner as to charge his bondsman. Such a suggestion is entirely new in the law of trusts, suretyship and bankruptcy.

In arriving at this conclusion, the Court ignored the fact that one of the duties of the Trustee or Receiver is "to deposit all money received," and that the place of deposit is only partially limited in that it must be "in one of the designated depositories." (11 U. S. C. A. 75 (a) (3).)

The majority of the Court below apparently made the error of assuming that there was no discretion vested in the Trustee or Receiver in the performance of his duty of depositing and maintaining deposits of moneys. The contrary is the fact. In Chicago, in August, 1930, when Howard made the original deposits in question, there were twenty-one different banks that were qualified as depositories for bankrupt funds. (Tr. 112, 113.) At all times thereafter while Howard had estate moneys in the Phillip State Bank and Trust Company (hereinafter called the "Phillip Bank"), there were a substantial number of such depositories. The duty of the Trustee or Receiver being only "to deposit" such funds in a designated depository, it follows that, in depositing the moneys received, he has the duty and discretion of selecting any one or more of the designated depositories. In placing all of the funds received in a single depository he could not ignore the relation of the size of the depository bond to the aggregate amount of money he placed or maintained in the depository, nor could he ignore the size or strength of the depository with relation to the amount of money deposited therein by him as such Trustee or Receiver, nor could he ignore information which he had relative to its solvency. These are ordinary duties of a trustee or receiver in making and maintaining deposits. These duties rested solely on him. Each time that Howard made a deposit for any bankrupt estate, and at all times while he maintained such deposits, he was subject to the test of ordinary care in a man depositing and

maintaining deposits of his own funds and being limited to banks that were designated depositories.

Howard voluntarily prejudiced his judgment as to the Phillip Bank in the following manner:

Within one month prior to July 15, 1930, one Beutel, who was an official of the Central Trust Company of Illinois, told Howard that he was about to become president of the Phillip Bank (Tr. 164) and requested Howard to make bankruptcy deposits therein. This discussion continued after said Beutel assumed his duties with the Phillip Bank and, as a result, Howard, who had been depositing his bankruptcy funds in the Central Trust Company of Illinois and the Foreman-State National Bank (Tr. 155), in consideration of transferring and depositing his bankruptcy funds in the Phillip Bank, obtained an agreement that the Phillip Bank would make to Howard, personally, unsecured loans of sufficient funds to pay his unsecured loans in the Foreman Bank and the Central Trust Company, and, in addition, would give him further unsecured loans. (Tr. 257-8.) Thus, three things are evident,—first, an agreement to give a favor to a trustee or receiver in bankruptcy was exacted by Howard for depositing and maintaining deposits in a particular bank after it became a designated depository; second, Howard considered it necessary to have an agreement that loans be made to him, before he felt free to take his bankruptcy funds out of one depository and place them in another; and, third, he felt unable to remove the bankruptcy funds from the Central Trust Company and the Foreman Bank until he was able to pay the personal unsecured loans which he had therein. (Tr. 203, 257.) Subsequent larger borrowings and more critical conditions in the Phillip Bank, where he thereafter made all of his deposits, would greatly accentuate

the mental limitations that he had at the time he transferred his bankruptcy funds thereto. (Tr. 77, 78, 203.)

The above-quoted statement of the majority of the Court, in summarizing its opinion, cannot be justified by any cases that have been decided anywhere, either in Federal or State Courts.

There is no time or circumstance in which a person, occupying an official position of trust, can be justified either in absolute negligence or in bad faith in performing an official duty, even though it merely may be the exercise of discretion in selecting between depositories.

Under the theory of the Circuit Court of Appeals, the designation of several depositories by the District Court, permits a trustee or receiver maliciously to seek out the depository most likely to fail and keep all of his estate moneys therein without any liability arising therefrom upon his official bond.

## II.

**A failure to exercise ordinary care in the performance of a statutory duty is a breach of a bond requiring that an official shall in all respects faithfully perform all his official duties as a trustee and the duties of his trust.**

In the opinion of the majority of the Circuit Court of Appeals, there is an intimation that Howard, as trustee or receiver, might be liable for negligence in the performance of his duties in depositing or maintaining bankruptcy funds to his own credit in the Phillip Bank, without making his bondsman liable. (Tr. 402.) The most favorable assumption to Howard would be that a trustee or receiver in bankruptcy is in fact a public official. Then the rules having application would be the same as those applying to the lia-

bility on bonds of public officers, even though the funds managed by the trustee or receiver belonging to the bankrupt estates are in fact private funds. (*Florida Bank & Trust Co.* v. *Union Indemnity Co.*, 55 Fed. (2d) 640 (C. C. A.); *American Surety Company of New York* v. *Akron Savings Bank Company*, 74 Ohio St. 465, Aff. 212 U. S. 557, 53 L. Ed. 651), and are deposited in his own name (11 U. S. C. A. 75). The rule is clearly stated, with many authorities, in 22 R. C. L., page 496, Sec. 197, as follows:

> "The engagement of a surety executing such a bond rests on the same legal obligation as is by law imposed on the public officer himself. Whatever is a breach of the conditions of the bond as regards the principal is equally so as to the sureties, * * *." (Many authorities cited.)

In his dissenting opinion, Judge Evans stated:

> "In other words, a trustee is one who occupies a fiduciary relation towards the creditors of the bankrupt. His is a position of trust. When the trustee, Howard, arranged with the bank to get a personal loan for a substantial sum and in return agreed to deposit the moneys which belonged to the creditors of the various estates for which he was trustee in the bank that loaned him personally the money, he failed in his plain duty to the creditors. He could not avoid the consequences of that failure if loss resulted through a failure of the bank, by showing that the bank wherein the money was deposited was a bank of deposit." (Tr. 403.)

Thus, even though the rule applicable to public officials were applied, the liability of Howard and his bondsman would not be relieved.

The majority opinion cites certain cases with reference to the necessity of placing bankrupt funds in designated depositories, and the courts emphasize this requirement. We have, however, found no case which indicates that a

trustee or receiver in bankruptcy may ignore his knowledge of dangerous conditions when selecting one depository from among many; or that he may limit his freedom of action as trustee or receiver by placing himself under personal obligation. We submit that where the statute requires an official to place funds with which he is entrusted in a fiduciary capacity in a certain class of depository, and he has the right to select between several depositories within such class, the very selection is in itself a fundamental and necessary discretionary duty, in the exercise of which he is liable for negligence.

The general rule goes beyond the statements above made. Where a bond is given to secure moneys to be deposited in a designated depository, if the officer having charge of making the deposits places larger sums in the depository than the amount of the depository bond, under the apparent protection of such bond, such officer and his bondsman are ordinarily liable as insurers for any excess beyond the amount of the depository bond. (*State* v. *U. S. Fidelity & Guar. Co.,* 210 Wis. 178, 246 N. W. 434, 436; *Roberts County* v. *Wickard,* 53 S. D. 511, 221 N. W. 246; *State* v. *Carney,* 208 Ia. 133, 217 N. W. 472; *Mass. Bonding & Ins. Co.* v. *Steele,* 125 Neb. 7, 248 N. W. 648.) In other words, the protection that is given is co-extensive with the penalty of the bond.

The rule of the jurisdiction as to liability for the faithful performance of the duties of the depositing officer applies. If the money, when deposited, is in the name of the depositing officer the insurance rule ordinarily applies and the officer and his bondsman are liable for losses beyond the amount of the depository bond. If the money becomes the property of the State and the depository holds the money as the money of the State there may be no liability or there may be a divided responsibility depend-

ing upon circumstances or statutory rule. Bankruptcy funds are private and held by the trustee or receiver in a fiduciary capacity and, accordingly, he is held to strict liability for negligence in the management of such funds. (*In re Singer Furniture Corporation,* 47 Fed. (2d) 780, 784.)

This case was tried on the theory that Howard's duty was that of exercising ordinary care as a trustee or receiver in depositing and maintaining bankruptcy funds. There are no cases that we have been able to find, nor have any been pointed out, which relieve an official and his bondsman from liability for negligence in the management of private funds committed to his care.

## III.

**The jury, under suitable instructions, found that Howard had breached his official bonds.**

The official bonds of Howard provided that he should obey such orders as the Court might make with relation to the trust; should faithfully and truly account for all the moneys, assets and effects of the estate of each of said bankrupts which should come into his hands and possession; and that he should, in all respects, faithfully perform all his official duties as trustee or receiver.

a. Howard failed to obey the orders of the Court:

Evidence was introduced that Judge Carpenter, on July 1, 1931, entered an order requiring *receivers* to report to the Court the amount of funds in all depositories. (Tr. 145.) No such report by Howard from June 9, 1931, until after June 21, 1932, was found, although secondary evidence was given to indicate that something had been taken to the clerk's office from time to time. (Tr. 145,

153, 159, 184, 185, 187, 188, 204, 252, 277.) The jury was entirely justified in believing that Howard had not made any such report of the amount on deposit in the bank, save to a deputy clerk, on June 9, 1931, and none pursuant to the Court's order. Hence, if the order of July 1, 1931, by Judge Carpenter was the character of an order contemplated in the statutory duties of Howard, there was no primary evidence that he ever made a report of the funds in all of his bankrupt estates during the entire time that the funds were in the Phillip Bank.

b. Howard failed to account:

It may well be that the jury also believed that Howard had violated the provision of the bond requiring him to "faithfully and truly account for all the moneys, assets, and effects of the estate * * * which shall come into his hands and possession, * * *."

In 1 C. J. S. 576, the author states:

> "The verb 'account' is frequently employed with 'for,' and the term 'account for,' has, in various adjudications, been interpreted to mean paying over the money to the person entitled thereto; hence more than merely filing an exhibit or statement of account." (Citing authorities.)

The question of the duty of a fiduciary is considered under such an expression in the bond in *Hale County, Texas* v. *American Indemnity Co.*, 63 Fed. (2d) 275, on page 279. (C. C. A.)

It was within the contemplation of each of the bonds that, both as to receiver and trustee, moneys would come into Howard's hands and be accounted for. It was not accounting for money to place and keep it in a depository known to be on the verge of failure or, in handling the funds which came into his hands, to limit his power to act by taking special favors.

Also, there was an unconscionable amount of money continually kept on deposit and Howard had the primary duty of distributing such money. Howard had $416,833.90 of estate moneys on deposit in the Phillip Bank, when it closed. (Tr. 72.) For example, $132,707 went on deposit on August 25, 1930, to the credit of the National Theatre Corporation (Tr. 73), and $52,174.17 still was on deposit to the credit of such account at the time the bank closed, with only a $1,000 bond. (Tr. 24.) Because of the delay in payments, if for no other reason, and the final loss because of such delay, there was not a faithful accounting. A delay in payment of dividends may be a breach of duty to account. (Reference is made to Judge Evans' dissenting opinion herein. Tr. 403.)

c. Howard failed to perform his official duties:

There is a breach of the third provision of the bond requiring Howard, as trustee or receiver, "to faithfully perform all his official duties as such trustee." The occasion for requiring a depository bond is protection of the funds of bankrupt estates which are on deposit. (Gilbert's Collier on Bankruptcy, 2d Ed., Sec. 101 (b), page 929.) The bond required by statute was intended to protect the deposits. The condition of the bond of a trustee or receiver in bankruptcy is breached by the negligence, without corruption, of the principal in the performance of even a ministerial duty. (*U. S.* v. *Perkins,* 280 Fed. 546 (C. C. A.); *In re Hoyt, et al.,* 119 Fed. 987.) As is pointed out by Judge Evans, and as is shown in each bond, Howard occupied a trust or a fiduciary relationship. (Tr. 60, 65, 403.) (25 C. J., page 1118.)

It is a general rule that where, by statute, an official is required to deposit in a particular depository, this does not relieve such official from liability for malfeasance,

misfeasance or nonfeasance in the care of funds. (*Jordon* v. *Baker*, 252 Ky. 40, 66 S. W. (2d) 84, 93 A. L. R. 813; *Edwards* v. *Logan County*, 244 Ky. 296, 50 S. W. (2d) 83; *State* v. *McNamer*, 62 Mont. 490, 205 Pac. 951.) A public or quasi-public officer is liable for misconduct in the performance of his duties. (46 C. J., Sec. 398, page 1068, and Sec. 401, page 1069.) In fiduciary relationships involving trusts, a trustee or fiduciary may not place himself in a position in which his self interest will or may conflict with his duty as trustee. (65 C. J. 520, page 652; *Booth* v. *Greer Investment Co.*, 52 Fed. (2d) 857, 860 (D. C. Okla.); *Bennett* v. *Weber*, 323 Ill. 283, 294, 154 N. E. 105, 109.) Furthermore, a trustee or receiver must act in good faith and with ordinary prudence in making and maintaining deposits in a bank, otherwise he is liable for a loss occasioned by the failure of such bank. (53 C. J., Sec. 194, page 156; 65 C. J., Sec. 566, page 701, and Sec. 519, page 647; see, also, *Fidelity & Deposit Co.* v. *Redfield*, 7 Fed. (2d) 800 (C. C. A. 9th C.).

It will be observed that these principles apply to making and maintaining deposits, to the several runs on the Phillip Bank, to the reduction in the deposits, and to the various notices which came to Howard, from the officers of the bank (Tr. 169-178, 192-196, 259-263), from publications (Tr. 83-101, 271) and other sources. (Tr. 117-118, 120, 123-128.) Notice of facts which would put a man of ordinary prudence on inquiry under similar circumstances, will be construed as notice of all the facts which a reasonably diligent inquiry would disclose. This is a basic rule of the law of trusts and applies equally to the handling of bankruptcy funds by a trustee or receiver in bankruptcy. (46 C. J., Sec. 28, page 543; *Essex National Bank* v. *Hurley*, 16 Fed. (2d) 427 (C. C. A. 1st C.);

*Grandison* v. *National Bank of Commerce*, 231 Fed. 800, 809 (C. C. A. 2d C.); *Martin* v. *Federal Surety Co.*, 58 Fed. (2d) 79 (C. C. A. 8th C.); *Coder* v. *McPherson*, 152 Fed. 951 (C. C. A. 8th C.); *McClean* v. *Bradley*, 282 Fed. 1011, Aff. 299 Fed. 379 (C. C. A. 6th C.), Cert. Den. 266 U. S. 619, 69 L. Ed. 471.)

Under the facts in this case the jury might well have been peremptorily instructed to find for the plaintiffs. The violations of duties, above set forth, were all admitted with the exception of the failure to make reports of total deposits. Both as to the violations of the second and third provisions of the bonds, the facts which are stated were not denied. In fact, they were testified to by Howard and the officers of the Phillip Bank who testified in his behalf. (Tr. 162, 191.) The instructions to the jury (Tr. 297-300) were based on the duty of Howard, as trustee and receiver, to use the degree of care which would guide a reasonably prudent man in the conduct of his trust responsibilities. The jury, on a consideration of the foregoing facts, found that Howard had breached his bonds, and that he and his bondsman were liable.

## IV.

**The public fund depository system (31 U. S. C. A. Sec. 476) and the plan provided in Section 47 of the Bankruptcy Act (11 U. S. C. A. Sec. 75) and Section 61 of the Bankruptcy Act (11 U. S. C. A. Sec. 101) have no relation to each other.**

Moneys paid to public officers are ordinarily funds of the United States and belong to the United States in the hands of the depositories. Moneys in the hands of receivers in bankruptcy are private funds belonging to pri-

vate individuals and trustees have the title to bankrupt funds as private funds. Such funds are placed in the depository in the names of the receivers or trustees and they have dominion and control over such funds, except as to certain formalities.

The general rule is that where Federal moneys, or moneys under the control of the Federal Government or its officers, are concerned, such officers and their bondsmen are held to a strict accountability, except in so far as they are relieved by statute. We have called the Court's attention to the fact that an obligation of the surety upon the bond and the duty of a public official are co-extensive, and that whatever is a breach of the conditions of the bond, as regards the principal, is equally so as to the surety. (Page 19, *supra.*) (22 R. C. L., page 496, Secs. 176, 189; see, also, Perm. Supp. and 1936 Supp. under the same sections.) This is true whether the bond is voluntary or required by statute. (Same volume, Sec. 178.) It is equally true if a tort is committed while the officer is acting within the scope of his authority, and it is now generally held that it is immaterial whether the act is done by virtue of the office or under color of office. (22 R. C. L., Sec. 190, page 507, note 2; also 46 C. J., page 1069, Sec. 401.)

Therefore, if the rules which apply to bonds of public officials may be considered in this case, either there is no liability upon the Trustee or Receiver for any act which he may commit, no matter how negligent, wilful or deliberate, or else the bondsman is liable for any loss resulting from any such act.

The question of liability on bonds of public officials for the protection of public funds is discussed most elaboratory in a note in 93 A. L. R. on page 819, where the author states:

> "Upon the general question there exists an irreconcilable conflict of opinion. The weight of authority, numerically at least, adheres to a doctrine of strict liability, holding that such an officer is not to be exonerated by any consideration of honesty, diligence, and faithfulness in the case of the loss of public money while in his hands, unless the loss shall have been occasioned by the act of God or the public enemy."

The respondents cited a great number of cases in the lower court, the major number of them cited in this particular authority, and the majority of the Court below has cited a number of them in its opinion. We respectfully submit that we have refrained from considering them at length because they would merely show a great contrariety of opinion and different practices in different States, and would be of no real benefit in this discussion.

The receiver or trustee in bankruptcy deals with private funds which are deposited in his own name and which he primarily controls. In the instant case, the jury found that in depositing and maintaining such private funds in his fiduciary capacity Howard breached his bonds. This question as related to the facts of this case never has been adjudicated in a court of record, but by every rule of reason, common sense and common honesty, and by analogy with appropriate decisions, the surety on Howard's official bonds is liable for his gross negligence.

## V.

**No precedents can be obtained from the decisions, as to the liabilities of sureties upon official bonds for public funds under State statutes, which are of any benefit in the general consideration of the rules regarding liability for the loss of bankruptcy deposits in bankruptcy depositories.**

It may be stated that, following the early Federal rules, the greater number of States follow the doctrine that public officers holding title to public money are the insurers of the funds in their possession, particularly if the title to such funds remains in the person making the deposit.

*U. S.* v. *Thomas,* 15 Wall. 337, 21 L. Ed. 89.
*Boyden* v. *U. S.,* 13 Wall. 17, 20 L. Ed. 527.
*Wiley* v. *Sparta,* 154 Ga. 1, 114 S. E. 45, 25 A. L. R. 1342.

In a few States the courts have adopted the bailee rule where they have felt that the insurance rule is too severe, and in such States the rule is that where the depositing officer fails to exercise ordinary care or is guilty of negligence, he and his bondsman are liable for a loss of funds. In still other States, the legislatures have made the depositories themselves public officials and the money in their hands becomes public funds and the officer making the deposit thereby is relieved from all liability because he has no title to such funds. There are some variations of these rules not necessary in this discussion.

In *Hamden* v. *American Surety Co.,* 9 Fed. Supp. 733, the Court considered the general theories of liability upon surety bonds, in dealing with the question of the

liability of the treasurer of a town in Connecticut. It referred to the original insurance rule of liability for loss of public funds by Federal officials and to the subsequent modifications as to the deposits of public funds from a Federal standpoint, (31 U. S. C. A., Sec. 521, and 12 U. S. C. A., Secs. 391, 392), which permitted the secretary of the treasury to designate any of the Federal Reserve Banks as the depositories or fiscal agents of the United States and pointed out that, in effect, Federal funds, when deposited in such Federal Reserve Banks, are in the treasury of the United States. The Court later said, in reference to bonds given to secure Federal funds, page 738:

> "The policy of these statutes and the unqualified undertakings of official bonds given in conformity therewith, the Supreme Court has indeed declined to relax."

However, in considering the question of bonds given to secure State officials, the Court said:

> "Indeed, the liability of a state official, as well as the construction of his official bond, is a matter of local law as distinguished from one of general jurisprudence. *Bassinger* v. *U. S. Fidelity & Guaranty Co.* (C. C. A.) 58 F. (2d) 573, certiorari denied 287 U. S. 622, 53 S. Ct. 21, 77 L. Ed. 540. Necessarily the liability of such an official will depend on state statutes, if such exist; and in the absence of statute, on the common law of the state which in large measure must be deduced from the administrative system of the state."

The note in 93 A. L. R. on page 819, previously referred to, accentuates the fact that until this Court has passed upon the rules in this particular situation, the most direct authorities are those cases which consider the negligent management of trust funds, primarily those having to

do with deposits in banks. Neither the majority of the Circuit Court nor counsel for Respondents have considered the fact that beyond the amount of the depository bonds there is no protection to the bankruptcy deposits, save the size and strength of the bank in which the money is deposited.

The whole history of surety bonds, in so far as the Federal Government is concerned, shows an adherence to the doctrine of strict liability. The District Court applied the liberal bailee theory in instructing the jury, in spite of the action of Howard in limiting his power of selection between depositories by accepting personal favors. Because of the application of this rule, the instructions were less stringent than they properly might have been under the law and facts of the case.

## VI.

**Neither the Congress of the United States nor the State Legislatures can constitutionally relieve public officials or quasi-public officials of the United States or the States from the result of their negligence.**

There is some possible basis for the State or Federal Government, if it should see fit to do so, to grant relief from the rigorous rule of insurance by public officials and their bondsmen in times of great stress and where no negligence has occurred in the management of such funds. However, there is no condition where the State or Federal Government has released a public officer or his bondsman from liability for loss resulting from direct negligence in the deposit of public funds when he has any power of selection between depositories.

In an extensive note in 38 A. L. R., referring to the

loss of public funds, the author, citing many cases, said, page 1513: -

> "A majority of the courts hold that an act of the legislature designed to relieve a public officer or his surety from liability for the loss of public funds, *occurring without the fault of the officer,* is constitutional; * * *." (Italics ours.)

This power to relieve the officer applies only to *public* funds and only when the public officer was not at fault. In the instant case *private* funds were involved and the fault of the officer, Howard, was shown.

To deny the right to recover for the negligence of the trustee or receiver herein would be a deprival of property without due process of law in violation of the 5th amendment to the Constitution of the United States.

In 2 Cooley on Const. Lim., it is said on page 758 (8th Ed.):

> "But a vested right of action is property in the same sense in which tangible things are property, and is equally protected against arbitrary interference. Where it springs from contract, or from the principles of the common law, it is not competent for the legislature to take it away."

In *Angle* v. *Chicago, St. P. M. & O. R. Co.,* 151 U. S. 1, 38 L. Ed. 55, it is said on page 65:

> "An executive may pardon and thus relieve a wrongdoer from the punishment the public exacts for the wrong, but neither executive nor legislature can pardon a private wrong or relieve the wrongdoer from civil liability to the individual he has wronged."

*Muir* v. *L. & N. Ry. Co.,* 247 Fed. 888, 897.

12 C. J., Sec. 551, page 972.

Black, Const. Law, 3rd Ed., page 602.

## VII.

**Howard violated each of the bonds that he gave as trustee and receiver, and his surety is liable for loss resulting from each of such violations.**

To summarize—prior to the time that Howard made any deposits in the Phillip Bank, he discussed transferring deposits which he had in certain large Chicago depositories, to the Phillip Bank, a small outlying depository. He had unsecured loans in such depositories and did not feel that he could transfer such deposits unless he obtained money to pay off the loans which he had therein. He came to an agreement with the executive officers of the Phillip Bank that they would loan him money to pay off his personal unsecured loans at other banks if he would transfer his bankruptcy funds to the Phillip Bank when it became a qualified depository. On August 20, 1930, said bank qualified as a depository, and before the end of that month $249,533.32 was deposited against its $50,000 depository bond. Said bank then had $3,401,014.29 of total deposits. Such excessive deposits were evidence of questionable faith in the performance of Howard's duties as trustee or receiver. As a condition of making such deposits there was a further agreement that Howard should be given such additional loans as he required. Prior to the time of making any deposits therein, Howard received $11,000 from the Phillip Bank which was more than enough to pay off his aforesaid personal loans. Subsequently, his unsecured borrowings therefrom increased to $18,515, of which $17,500 was not repaid at the time said bank failed on June 21, 1932. He was told by the officers of the Phillip Bank of runs in April, June, September and December of

1931. Howard knew that the result of each of said runs and particularly the cumulative effect thereof was to impair, if not destroy, the possibility of withdrawing the large demand deposits of his estates.

The evidence is replete with the talks that Howard had with the bankers and assurances that another bank was backing the Phillip Bank. (Tr. 199, 261, 262.) Any reasonable man, depositing his own funds in a bank, would not be so unwise as to depend on assurances of protection by another bank which was under no legal responsibility to protect his funds. The reason for Howard failing to withdraw his funds is plain. If Howard had attempted to remove any substantial portion of his bankruptcy funds from the Phillip Bank, the probability was that he would be called upon to pay off his personal loans and if he could not do that he would be destroyed financially as he "was not a man of any means." (Tr. 257.) If, on the other hand, he left the bankruptcy funds in the bank, there was a slight possibility that the bank might stay open. He took that chance with the bankruptcy funds in the attempt to save himself, with the resultant loss to the creditors of the various estates.

Under the Bankruptcy Act, Howard had no duty as a trustee or receiver for hire, to advance funds to the estates or in any way to commingle his personal affairs with those of the trusts. The fact that he advanced funds did not excuse his having accepted favors from the bank and thus placing himself in a position where it was necessary for him to make his fiduciary obligation subservient to his personal interests.

Much was said in the opinion of the Circuit Court about other banks and other trustees. The method of operating bankruptcy and receivership estates by other trustees and receivers is not here involved.

Howard is liable because of negligence in the conduct of his estates and his surety is equally liable.

The Court has recently recognized some of the difficulties that have arisen in connection with bankruptcy funds that are placed in designated depositories and has adopted an order safeguarding the depository bonds. (General Order LIII.) This order and these safeguards do not meet the present situation as here the depository bond was paid and the loss is for deposits in excess thereof. If the decision of the Circuit Court is permitted to remain law, there is no safeguard against depositories bidding against each other by the promise of personal favors to a trustee or receiver, nor any safeguard against negligence on the part of a trustee or receiver in depositing or maintaining bankruptcy funds.

Respectfully submitted,

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IN THE

# Supreme Court of the United States

OCTOBER TERM, A. D. 1937.

## No. 30

UNITED STATES OF AMERICA, on relation of Chester A. Willoughby, as Trustee in Bankruptcy of National Mechanical Service Company, a corporation, et al,

*Petitioners,*

*vs.*

SAM HOWARD and CONTINENTAL CASUALTY COMPANY, a corporation,

*Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

## BRIEF FOR PETITIONERS.

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